

Modulation and financial discipline

The 2003 CAP reform

The June 2003 CAP reform changes the way the Common Agricultural Policy operates. Among several key initiatives, it contains two instruments that set new parameters for CAP financing.

A '*financial discipline*' mechanism will be applied in order to keep CAP spending beneath strict budgetary ceilings. And, the instrument known as '*modulation*' provides a means to ensure the transfer of CAP funds from direct aids to farmers and market measures ('*Pillar 1*' of the CAP) to rural development measures ('*Pillar 2*').

A. Financial discipline mechanism

There have been limits on CAP expenditure for several years, latterly following the 1999 CAP reform (known as 'Agenda 2000') which fixed ceilings on annual spending on for the 2000 to 2006 period. More recently, at the European Council in Brussels in October 2002 strict budgetary ceilings were laid down by EU leaders to cover spending in the 2007 to 2013 period.

The subsequent 2003 CAP reform introduced a financial discipline mechanism to ensure that the amounts for the financing of the CAP currently under subheading 1a ('Pillar 1') of the 'financial perspective' are not exceeded in any year. Starting with the 2007 budget an adjustment of direct payments will be proposed when forecasts indicate that the spending amounts budgeted under Pillar 1 will be exceeded in a given budget year. So, if there is a danger of overspending, cuts in direct aids should be made.

It is important to note that the budgetary ceilings established in October 2002, and the financial discipline mechanism, apply only to Pillar 1 spending. Spending on rural development measures (Pillar 2) is not governed by these measures.

Note: This mechanism operates without prejudice to the financial perspective to be adopted for the 2007 to 2013 period. Decisions on the new perspective for that period may entail new arrangements being adopted.

How financial discipline works in practice

The aim is to anticipate budgetary problems before they occur. The European Commission will assess whether there is a prospect of a budget overrun, in any one budget year, during the preceding year and then propose action to address this.

For example, for the first year of application the Commission will, by 31 March 2006, make a proposal to the Council for adjustments to spending if it projects an overrun in Pillar I (market measures and direct aids of the CAP with a margin of EUR 300 million) of 2007 budget. The Council must decide on that proposal by 30 June 2006, and the 2007 budget (the relevant budget year for Pillar 1 expenditure in 2006) can be adjusted accordingly. In practice this means the Commission will propose reductions in direct aids of Pillar 1 measures.

Does financial discipline apply throughout the EU?

The discipline mechanism applies in all EU Member States except in the 10 countries that joined the EU in May 2004. Financial discipline will not apply to those countries until direct payments reach EU levels after being phased-in.

B. Modulation

The need to reinforce EU rural development measures has been an important issue over recent years, in response both to public concerns and to the needs of rural areas. The idea of reducing spending on Pillar 1 measures and transferring the funds to be spent on Pillar 2 measures (known as modulation) is not new. Under the Agenda 2000 CAP reform Member States had the option to apply modulation on a voluntary basis. Few did so, for a variety of reasons.

The 2003 reform expands the concept significantly.

Modulation becomes compulsory – Member States must apply it at the rates set in the reform. It applies to all farmers across the EU with exception of the smallest. In order to finance the additional rural development measures agreed in the reform, all direct payments (SPS and other direct aids) will be reduced, by 3 % in 2005, 4 % in 2006 and 5 % from 2007 onwards until 2012.

One percentage point (i.e. 33 % in 2005, 25 % in 2006 and 20 % in the following years) of the modulation money generated in a particular Member State will be allocated to the Member State concerned. The remaining amounts will be re-distributed among Member States according to objective criteria:

- agricultural area,
- agricultural employment,
- GDP per capita in purchasing power.

However, every Member State will receive at least 80 % of its modulation funds. A Member State with a high proportion of rye as part of its total cereal production (5 % on average during the period 2000-02), and a proportion of total EU production of rye (exceeding 50 % during the same period), will have at least 90 % of the amounts generated by modulation reallocated to it (until 2013 inclusive).

Does modulation apply to all EU farmers and all direct aid payments?

Direct payments up to an amount of EUR 5 000 per farm will remain free of reductions. Outermost regions of the EU will be exempt from modulation¹. Modulation reductions in direct payments will not apply in the accession countries until direct payments reach EU levels (scheduled for 2013).

Can ‘domestic modulation’ continue?

There are rules established to cover the transition from voluntary national modulation (where it existed) to the new EU system. They contain provisions to enable continuation

¹ The French overseas departments, the Azores and Madeira, the Canary and Aegean islands.

of domestic modulation up to the level required to fund certain rural development measures ('accompanying measures') established before 2006. For a certain period going beyond 2006 this will mean that voluntary and compulsory modulation may operate in parallel.

What are funds to be used for?

There are no EU rules specifying exactly what Member States may do with the funds provided by modulation. Member States may use all the instruments available under rural development measures funded by the 'guarantee' section of the agricultural budget. In practice this means all rural development measures other than those taking place in 'Objective 1' regions², and the Leader programme³.

Application at farm level

Modulation will be applied, at the appropriate percentage level in the year in question. All direct aid payments will be reduced. The first EUR 5 000 of every farmer's total direct payments is not subject to modulation so Member States have to repay the corresponding amounts as so-called 'additional aid'.

Practical examples: a farmer entitled to EUR 2 000 of direct payments in 2007 will first see his payments being reduced by EUR 100 (full 5 % modulation), which must be returned to him in full before 30 September. On the other hand, a farmer entitled to EUR 10 000 of direct payments in 2007 will first see a reduction of EUR 500 in his payments (full 5 % modulation) of which he will later receive back EUR 250 (additional aid equivalent to modulation of the first EUR 5 000).

Results

A modulation rate of 5 % will result in additional rural development funds of approximately EUR 1.2 billion a year being made available. This will allow for a significant extension of the scope of rural development instruments. One key result of the modulation mechanism (and new rural development measures agreed as part of the 2003 reform) is that modulation money may now be targeted also at improving animal welfare, food quality and meeting standards.

The introduction of the financial discipline instrument will ensure that budgetary limits are respected. It should also help provide early warning of overruns. By helping the agricultural community to control budgetary problems, it should provide better guarantees for future aid payments.

Sources of further information

Council Regulations N° 1782 and N° 1783 of 29 September 2003

(OJ L 270, 21.10.2003)

Commission Regulation N° 795 of 21 April 2004

(OJ L 141, 30.04.2004)

Commission Regulation N° 796 of 21 April 2004

(OJ L 141, 30.04.2004)

² Areas lagging behind in their development, where the GDP is below 75 % of the EU average

³ Leader+ is one of four 'Community Initiatives' financed by EU structural funds and designed to help rural actors improve the long-term potential of their local region.

Commission Regulation N° 1973 of 29 October 2004
Commission Regulation N° 1655 of 22 September 2004

(OJ L 345, 20.11.2004)
(OJ L 298, 23.09.2004)

For information on the reform, Directorate-General for Agriculture and Rural
Development of the European Commission:
http://europa.eu.int/comm/agriculture/index_en.htm